No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM 1943

JOE DEGNAN, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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I.

OPINIONS OF THE COURTS BELOW

The Opinion of the Circuit Court of Appeals is reported in 136 F.(2d) 891, and in the record at pages 50 to 57. The Opinion of the Board of Tax Appeals is reported in 47 BTA 122 and appears in the record at pages 22 to 30.

II.

JURISDICTION

The date of the judgment to be reviewed is June 29, 1943 (R. 57).

Jurisdiction of this court to review the judgment of the Circuit Court of Appeals by the writ of certiorari is invoked under Judicial Code, §240, as amended by the Act of February 13, 1925, 43 Stat. 938; 28 U.S.C.A., §347.

III.

STATEMENT OF THE CASE

We are content to state the facts in the language of the Circuit Court of Appeals, as follows:

> "Petitioner Degnan and one Toivo J. Rosander entered into the partnership of Degnan and Rosander. The partnership acquired a metal mine in Alaska and derived the first items of deductible expense with respect to the property subsequent to the date of acquisition, May 12, 1938.
>
> "Pursuant to an agreement of the partners the net income of the partnership for 1938 was distributed to Degnan. He filed a timely individual income tax return for the calendar year 1938, reporting all income from and claiming deductions relating to the metal mine. No deduction for depletion was included. The other partner, Rosander, also filed a timely individual return for 1938, showing no income and no deduction with reference to the mining property.
>
> "Although no request for an extension of time to file had been made or granted, a 1938 return for the partnership was not filed until September 18, 1940. Fifteen per cent of the gross income from the Alaskan mine, or $810.00, was one of the deductions claimed. The face of the return contained the statement: 'We elect to take depletion on basis of 15% of gross as provided by law.'
>
> "A timely partnership return for the year 1939 was filed on March 29, 1940. It too included a deduction of fifteen per cent of the reported gross income from the mine, or $5,110.30, and alleged: 'Election is hereby made to take depletion on the percentage basis as provided in

Section 114 (B) (4) Revenue Act of '32 and '34.' Neither partner in his individual return for 1939 included any item for depletion with respect to the property.

"The Commissioner determined a deficiency of $224.51 against the partnership for the year 1939 on the ground that no election permitting the computation of depletion on the percentage basis had been made pursuant to §114 (b) (4). The Board of Tax Appeals upon a stipulation of the facts reached an opinion in accord with that of the Commissioner. Degnan seeks reversal.

"The case involves the interpretation of applicable clauses of §114 (b) (4) of the Revenue Act of 1938, 26 U.S.C.A. Int. Rev. Code §114 (b) (4)[1], which permits a depletion allowance in the case of metal mines of fifteen per cent of the gross income from the property, requires a taxpayer to elect the percentage depletion method of computation in his 'first return * * * in respect of a property' and provides that in the absence of such an election the percentage method will not be considered. Whichever system of computation is first selected under the section will prevail in subsequent years. The depletion allowance constitutes a deduction in computing net income under §23 (m)." (R. 50 to 53)

IV.

SPECIFICATIONS OF ERROR

1. The Circuit Court of Appeals erred in holding that the partnership return for 1939 was not a "first return" within the purview of the statute.

2. The Circuit Court of Appeals erred in holding

that the partnership return for 1938 did not make an effective election entitling the taxpayer to the benefit of percentage depletion, because "not timely filed."

V.

ARGUMENT

In this case the partnership filed two returns in which it claimed an election to take percentage depletion, one for 1939 and one for 1938. If the return for the year 1939, which was the first return filed by the partnership, was a "first return" within the meaning of the statute, then the decision of the Circuit Court of Appeals is erroneous. This return was in all respects a proper return for the year in question and was filed in due time. The only basis upon which it was denied validity is that the regulations of the Treasury Department had purported to define "first return" as the return made for the first taxable year for which the taxpayer has any item of income or deduction with respect to such property. As we shall demonstrate under our first point below, it was not within the power of the Treasury Department by such a regulation to alter the plain meaning of the statute.

If this court should not agree with us upon this point, however, then it is our contention that the 1938 return was a proper medium in which the partnership might exercise the election accorded by the statute, and that the Circuit Court of Appeals erred in denying effect to this return for such purpose because it was tardily filed, it being our contention that the statute here under consideration did not make timeliness

of filing such return a condition of the right to make the election accorded by statute.

A.

The Partnership Return for 1939 Was a "First Return" Within the Purview of the Statute

At the outset we take it as axiomatic that if a statute is unambiguous and clear, and a literal interpretation does not lead to absurdity nor do violence to the purpose of the legislation as reflected by its legislative history, there is no room for construction, and the ordinary meaning of language should be allowed to prevail. *Helvering v. Hamel*, 311 U.S. 504, 510. By the same token departmental regulations are appropriate only where a statute is ambiguous or so general in its terms as to require interpretation. The Treasury Department cannot by regulation enlarge or modify the scope of a statute. 1 Mertens: Law of Federal Income Taxation, 87-89.

Accordingly, in the instant case, we deem it appropriate to point out that there is nothing in the legislative history of §114 (b) (4) which impels any departure from literal meaning. *Mother Lode Coalition Mines Co. v. Commissioner*, 317 U.S. 222, 226—footnote 4.

Also, if as that decision holds, "first return" means just what it says (p. 226) and not "first return made by a taxpayer having net income derived from a property," it would seem obvious that "first return" in the section may not properly be tortured into "the return made under that title for his first taxable year

(beginning after December 31, 1937) for which he has any item of income or deduction with respect to such property," as was attempted to be required by Article 23 (m)-5, Treasury Regulations 101, under the Revenue Act of 1938.[2]

The "first return" under §114 (b) (4) in the instant case was the partnership return of Degnan and Rosander for 1939 (R. 18, paragraph 8). Neither the Regulations of the Treasury Department nor the belated filing subsequently of a partnership return for 1938 (R. 17, paragraph 7) could properly deprive it of that status under the statute.

Nor does according their ordinary meaning to ordinary words in this situation lead to any absurdity. If a "first return" is held to mean just that, then an election expressed in the first return settles the issue. There is involved no question of recomputation of anything as in the case of amended returns, and the anxiety of the Circuit Court of Appeals regarding such complication stems from the failure of that Court to recognize that the instant case does not concern amended returns, or rights of amendment. This case involves original returns only and there was here, we submit, no proper occasion for discussion of the circumstances under which amendments may be allowed. Neither, in the instant case, was there any shifting or attempting to shift from one basis of depletion to another. The same election was expressed in both returns and there was no proper occasion to advert to

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[2]The full text of this article of the Regulations in question is set forth in the Appendix, *infra*, p. 3A.

confusion which would result if taxpayers were allowed to amend and shift. We have not asked that we be allowed to change any election we have made.

In this connection, further, while the partnership return for 1939—the "first return"—was "timely filed" (R. 18, paragraph 8), the holding of the Circuit Court of Appeals that it would cease to be so if tardily filed, seems strained and erroneous. We concede, of course, that Congress might have provided that a first return under this section should cease to be so unless filed by March 15th. But we submit that Congress can speak more plainly, and should be required to speak more plainly than has been done in any of the legislation now before the Court, to accomplish such a startling and momentous result. It will be recalled that the election provided for in the "first return" under this section governed not only the taxable year involved in the return itself, but all future years. If this Alaskan miner, Joe Degnan, is forever to be barred from claiming percentage depletion unless the critical partnership return is posted by midnight of March 15th, or within such extended period not exceeding six months as the Commissioner in the exercise of his uncontrolled discretion may upon application during such period allow, common fairness would seem to require that the law say so in terms which Joe Degnan can be shown. Yet the Circuit Court of Appeals says in the instant case:

> "It is true that both the section and the regulations are silent as to the time within which the 'first return' must be filed." (R. 54)

Not only that, but nowhere in the statute nor in the

regulations is there any intimation that tardiness in filing the return causes it to cease to be a return, or precludes the exercise of the statutory election therein.

Penalties for tardiness in filing, and for willful failure to file, are provided in detail by the Internal Revenue Code. Thus §291 provides an *ad valorem* penalty up to 25% for failure to file a timely return. §293 (b) adds another 50% if the delay is fraudulent. Finally §145 imposes the sanctions of the criminal law upon those whose failure to make a return is willful. Surely these statutory goads to action should allay the concern of the Circuit Court of Appeals about the possibility of a taxpayer postponing indefinitely filing his "first return" to his personal benefit and administrative confusion. If not, the remedy, we think, is for Congress and not for the courts by way of judicial legislation.

These statutory penalties, moreover, mark the distinction between the position of a taxpayer who files a belated original return and one who seeks belatedly to amend a timely original return. The former has presumably become liable to some penalty, the latter obviously has not. So there is no lack of logic in according them different treatment, a point which troubled the Board of Tax Appeals (R. 28). For this reason, likewise, the reasons cited by the Circuit Court of Appeals for imposing a time limit upon the judicially accorded privilege of amendment are not properly applicable to the instant problem, dealing, as it does, only with original returns and the meaning of the words of a statute.

So we say the statutory "first return" in the in-

stant case was the partnership return for the year 1939 and that the Regulations of the Treasury Department which would make a different return the "first return" in violation of the plain meaning of the statute are palpably erroneous and, in that far, void.

Legislative Approval of Regulations

The only attempted answer to this reasoning to be found in the opinion of the Circuit Court of Appeals is the suggestion that these regulations were the subject of legislative approval under the doctrine of the first *Reynolds* case (*Helvering v. Reynolds Tobacco Co.*, 306 U.S. 110).

The reply to this position is threefold:

(1) The doctrine that the absence of corrective legislation demonstrates legislative indorsement of regulations issued under prior law when the law is reenacted has never been deemed to apply where the law is plain and the regulation patently erroneous.

Louisville & N. R. Co. v. U. S., 282 U.S. 740;

U. S. v. Missouri Pac. Rd. Co., 278 U.S. 269, 280;

Iselin v. U. S., 270 U.S. 245;

U. S. v. Maryland Casualty Co. (C.C.A. 7) 49 F.(2d) 556;

Biddle v. Commissioner (C.C.A. 2) 86 F. (2d) 718, aff'd. 302 U.S. 573;

1 Paul & Mertens: Law of Federal Income Taxation, 52;

1 Mertens: Law of Federal Income Taxation, 88, 96.

(2) The doctrine of the first *Reynolds* case, even where the statute is ambiguous, is fallacious as applied to income tax regulations where the precise point involved is not shown to have been considered by Congress, and subsequent decisions of this court have either greatly restricted, or altogether overruled it.

Thus in *Helvering v. Hallock*, 309 U.S. 118, 121, it is said:

> "we walk on quicksand when we rty to find in the absence of corrective legislation, a controlling legal principle."

Mr. Mertens in his Law of Federal Income Taxation, p. 101, says of the present status of the first *Reynolds* case:

> "In *Helvering v. Reynolds* (313 U.S. 428), the United States Supreme Court substantially qualified, if it did not reverse, the general principle of statutory construction on which the decision in the prior *Reynolds* case was premised. It will be recalled that the Supreme Court in the earlier *Reynolds* case, which involved a sale of treasury stock, held that the regulations in effect over a long period of years, during which years the statute was frequently reenacted without change, acquired the force and effect of law. In the later *Reynolds* case the Court, without stopping to inquire whether prior interpretations as disclosed by administrative practice and rulings and lower federal court decisions were so uniform and consistent as to fall within the rule of Congressional adoption through re-enactment of the statute, declared that: 'That rule is no more than an aid in statutory construction.'

> "The later *Reynolds* case very clearly demonstrates the tenuous character of rules of statutory construction. The language of the various decisions in which the courts have appeared to place material reliance on the legislative history and other aids to construction as a matter of substance and merit should not be unduly relied upon. It is becoming increasingly apparent that on the whole these aids to construction are really no more or less than just that and that while they are useful at times in resolving statutory ambiguities they will be given the force and effect of law only under very limited and usual circumstances."

At page 97, Mr. Mertens refers to the doctrine of the first *Reyonlds* case, as applied to income tax legislation, as an anachronism in view of the complexity of income tax statutes and the frequency of their re-enactment. He says:

> "To suppose that Congress must correct each mistaken construction under the penalty of otherwise incorporating it into the fabric of the statute appears unwarranted."

The doctrine has been severely and properly criticised in texts and Law Review articles. Paul, Use and Abuse of Tax Regulations in Statutory Construction, 49 Yale L.J. 660, 663; Paul, Studies in Federal Taxation (3rd series) 426; Griswold, A Summary of the Regulations Problem, 54 Harvard L. R. 398, 400; Alvord, Treasury Regulations and the Wilshire Oil Case, 40 Columbia L.R. 252; Surrey, The Scope and Effect of Treasury Regulations under the Income, Estate and Gift Taxes, 88 U. of Penn. L.R. 556; Brown, Regulations, Re-enactment and The Revenue Acts, 54

Harvard L.R. 377; Feller, Addendum to the Regulations Problem, 54 Harvard L.R. 1311; Griswold, Postscriptum, 54 Harvard L. R. 1323.

We submit that there is not strength enough left in the doctrine of the first *Reynolds* case to overcome the plain meaning of the statute and to justify denying to the 1939 return its manifest status as the "first return."

(3) Finally, if the doctrine of legislative approval has any potency, what of legislative disapproval? It is to be recalled that in the instant situation, the requirement of election which was provided by §114 (b) (4) has now been eliminated from the section by §145 (a) of the Revenue Act of 1942—Public Law No. 753, 77th Congress, 2nd Sess. If re-enactment spells approval, should not repeal indicate disapproval? If the former gives potency, should not the latter altogether abolish?

In conclusion, therefore, on this point we believe we have demonstrated that the 1939 return was the "first return" under the statute; that it was in all respects proper, and that the election therein properly set forth should have been given effect.

If we be mistaken, however, in the foregoing position, and the Circuit Court of Appeals should be right in holding that our subsequently filed 1938 partnership return was the "first return" specified in the statute by reason of the Regulations, still our election therein set forth would have been proper and should have been, and should now be, treated as effective. The only consideration to the contrary is the sug-

gestion that this return was not "timely." Our answer is that nothing in the statute and nothing, for that matter, in the regulations imposes any such requirement upon an original return for this purpose.

B.

The Decision of the Circuit Court of Appeals Erred In Holding That Timely Filing Is a Requisite for An Election to Take Percentage Depletion In An Original Return

As above pointed out, §114 (b) (4) contains no requirement as to the time of filing returns. There is no specific reference, either in the body of the section or in its title, to the time element. The section requires only that the election be made in "*first* return under this chapter in respect of a property."

Penalties for lateness in filing are provided by other sections of the law. The Internal Revenue Code in §291 provides an *ad valorem* penalty up to 25% for failure to file a timely return. §293 (b) adds another 50% if the delay is fraudulent. Finally §145 imposes the sanctions of the criminal law upon those whose failure to make a return is willful. If these provisions are not severe enough, the remedy we think, is for Congress, not for courts by judicial legislation. An additional and more burdensome penalty should not be read into the statute by implication. We respectfully submit that a duplication of penalties is not to be implied or assumed in the absence of clear and compelling language.

As the opinion of the Board of Tax Appeals herein

points out, "there appear to be no cases directly in point" on the construction of this section of the statute with reference to any requirement of the time of filing the return (R. 26).

In *Ardbern Co., Ltd. v. Commissioner of Internal Revenue*, 120 F.(2d) 424, however, the Circuit Court of Appeals for the Fourth Circuit decided an issue substantially similar to the instant one in accord with the proposition for which we here contend. The Court had before it in that case the construction of a statute concerning foreign personal holding corporations. Under the provisions of Section 233 of the Revenue Acts of 1928 and 1932 such corporations could receive the benefit of deductions and credits "only by filing or causing to be filed with the Collector a true and accurate return of total income from all sources in the United States prescribed" in the Act. In that case the taxpayer failed to file such an income tax return with the Collector until after the deficiency notice had been given. The Commissioner there, as here, contended that such a belated return could not be given any effect, relying strongly upon the case of *J. E. Riley Investment Co. v. Commissioner*, 311 U.S. 55, 61 S. Ct. 95, 85 L. ed. 36. The Court overruled the contention of the Commissioner upon the ground we here urge, in the following language:

> "While there is a specific penalty of 25 per centum fixed for failure to file tax returns, Section 291, Revenue Act of 1928, 26 U.S.C.A. Int. Rev. Acts, page 431, there is no provision that there shall be an added penalty in the form of not allowing the delinquent taxpayer deductions to which it otherwise would be entitled."

The Court distinguished the *Riley* case upon the ground that the latter case dealt with an amended return whereas in the *Ardbern* case, as here, the taxpayer's claim was based upon his "first" return.

Similarly, the Circuit Court of Appeals for the Fifth Circuit, in *Del Mar Addition v. Commissioner*, 113 F.(2d) 410, held that a delinquent capital-stock tax return, although filed only five days before the date set for hearing on deficiencies was to be given effect. In that case, the specific sections of the statute made no provision for the filing of delinquent returns. The court held, however, that since the general statute provided a penalty for delinquency, as in the case of §291 here, there was a necessarily implied right to file a delinquent return and that a "first return" under the statute there under consideration, did not cease to be such because not timely filed.

These cases from the Fourth and Fifth Circuits are, we submit, opposed to the holding in the instant case. Although cited to the court, they are not mentioned in the opinion. Certiorari should be granted to resolve the conflict in a situation which has not been passed upon by this Court.

The decision of the Circuit Court of Appeals herein quotes largely from the case of *Riley v. Commissioner*, 311 U.S. 55, and three other recent cases from this Court involving amended returns. These cases established the right of a taxpayer to make amendments—a non-statutory matter. Also, in the light of the administrative difficulties attendant upon an unlimited right to amend, these cases established a limit upon

such right. To us it seems clear that these cases are not in point here and the difficulties to which they advert are not present in our situation involving, as it does, only original returns and no attempted shifting. The language of those cases is to be considered in the light of the problems there before the court. Because in the *Riley* case, this court held that an amended return could not be filed after the delinquent date, it does not at all follow that an *original* return cannot properly be so filed. As above pointed out, there is no statutory penalty which would deter delinquency in making amendments of returns. There are specific statutory penalties which apply to tardiness in filing original returns. We believe these latter should here be held the exclusive penalties and that additional ones should not be supplied by judicial fiat.

The distinction between original and amended returns which seems to have escaped the Circuit Court of Appeals is well illustrated in *Jordan Creek Placers v. Commissioner*, 43 B.T.A. 131, 137, where it was held that a belated "first return" fixing capital stock tax status was to be given effect although recognizing that if there had been a prior return it would have been too late to amend under the doctrine of the *Riley* case.

To us it seems that the section in question presents no ambiguity. There is really no occasion for construction in the technical sense. If there were, however, we fail to find any empirical evidence from the legislative history of this section, as distinguished from juristic speculation, that literal interpretation defeats its purpose. With reference to supposed ad-

ministrative expediency, it is perhaps in order to recall that the requirement of election was first made a part of the Revenue Law in 1932 (Cf. *Tonopah Mining Co. v. Commissioner* (C.C.A. 3) 127 F.(2d) 239, 240). It is also proper to notice that it has been removed by the Revenue Act of 1942. As the fourth footnote to the decision in *Mother Lode Coalition Mines Co. v. Helvering*, 317 U.S. 222, 226, points out, nothing in the legislative history of the provision casts any light on its purpose.

Accordingly we respectfully contend that the Circuit Court of Appeals erred in attempting to add timeliness of filing to the requirements of §114 (b) (4).

VI.

CONCLUSION

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers and that a writ of certiorari should be granted to review and reverse the decision of the Circuit Court of Appeals herein.

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